STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission on its own motion	)	
Northern Illinois Gas Company d/b/a/NICOR Gas Company Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs prudently incurred	)	Docket No. 01-0705
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Northern Illinois Gas Company d/b/a NICOR Gas Company Proceeding to review Rider 4, Gas Cost, pursuant to Section 9-244(c) of the Public Utilities Act	)	Docket No. 02-0067
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BRIEF ON EXCEPTIONS OF THE CITIZENS UTILITY BOARD

ORAL ARGUMENT REQUESTED

NOVEMBER 28, 2012

Julie L. Soderna
Director of Litigation
CITIZENS UTILITY BOARD
309 W. Washington, Ste. 800
Chicago, IL 60606
(312) 263-4282

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BRIEF ON EXEPTIONS OF THE CITIZENS UTILITY BOARD

Pursuant to the schedule set by the Administrative Law Judges ("ALJs") and Section 200.830 of the Rules of the Illinois Commerce Commission, 83 Ill. Admin. Code Section 200.830, the Citizens Utility Board ("CUB"), through its attorneys, hereby submits its Brief on Exceptions in the above-captioned proceeding. In accordance with Section 200.830(b), CUB

submits its suggested replacement language in legislative format, as an attachment to this Brief on Exceptions (called "Exceptions").

I. INTRODUCTION

The Proposed Order virtually ignores the fact that Northern Illinois Gas Company, d/b/a Nicor Gas Company ("Nicor, "Nicor Gas" or the "Company") misled this Commission in seeking approval of its performance-based regulatory ("PBR") program, known as the Gas Cost Performance Program ("GCPP"), (approved by the Illinois Commerce Commission ("ICC" or "Commission") in Docket No. 99-0127). The deception continued when, during the operation of the GCPP, Nicor continually evaded detection of the driving purpose of the program, exploited the GCPP to its fullest extent throughout its operation to reward shareholders, and nearly avoided any consequences at all – that is, until a whistleblower sent an anonymous facsimile ("whistleblower fax") to CUB with information revealing the schemes hidden from the Commission. Nicor's failure to divulge to the Commission its intentions for the GCPP in Docket No. 99-0127, and continuing evasion of detection of these schemes, are the prevailing issues the Commission must address in this proceeding, because those actions undermined the regulatory compact and caused Nicor's ratepayers to pay excessive rates far beyond the amount Nicor already agreed to refund.

CUB takes exception to several of the Proposed Order's conclusions, as well as its general lack of context and analysis. CUB's attached Exceptions seek to fill out the core story line absent in the Proposed Order, to provide a more detailed and complete version of the events at issue. More importantly, however, CUB takes exception to several of the conclusions in the Proposed Order that ignore substantial record evidence and the burden of proof, disregard the

standard of proof, and overlook the criteria explicitly applicable to this proceeding. In fact, the Proposed Order fails to cite the applicable statutory criteria under which the GCPP must be analyzed pursuant to Section 9-244 of the Public Utilities Act ("PUA" or "Act"), let alone provide an analysis applying the facts in this record to that standard, and barely mentions the Commission's own Second Interim Order, which broadened the scope of review. The Commission must use these governing criteria as a guide when conducting its review of the GCPP in this proceeding, something the Proposed Order fails to do.

This proceeding is unique for many reasons: it is the oldest active docket currently pending at the Commission; it is one of the longest-enduring dockets of this Commission's history; the refunds requested are some of the largest in Commission history; this is the only alternative rate regulation approved for gas commodity charges by this Commission; and this may be the only instance of a federal investigation of a utility's conduct under a Commission-approved rate, with several federal indictments and a $10 million penalty paid to the Securities and Exchange Commission. This is the Commission's first and only opportunity to review the evidence of Nicor's conduct under its now-defunct Gas Cost Performance Program ("GCPP") – a program the Commission approved after concluding that it met the statutory mandate that it be "likely to lower gas costs for Nicor's customers." 220 ILCS 5/9-244(b)(1); *Northern Illinois Gas Company d/b/a NICOR Gas Company*, Petition for permission to place into effect proposed Rider 4, Gas cost, pursuant to Section 9-244 of the Illinois Public Utilities Act, ICC Docket No. 99-0127, Order at 39 ("*99-0127 Order*")("The Commission finds that the GCPP is likely to result in rates lower than those under traditional regulation as required by Section 9-244(b)(1)."). In Docket No. 99-0127, the Commission further concluded that there were "substantial and

identifiable benefits that will be realized by customers under the program that would not be realized in its absence as required by Section 9-244(b)(2)." *99-0127 Order* at 37.

Now, it is all too clear the real purpose of the GCPP was to enrich Nicor's shareholders at ratepayers' expense. Nicor accomplished this through deceiving the Commission, manipulating the GCPP in ways it claimed it could not, hiding documents, dodging inquiry and simultaneously denying any wrong-doing. Yet, to read the Proposed Order ("PO"), one would have no idea of the magnitude of the deception that occurred or the multitude of ways in which Nicor manipulated the GCPP to its advantage, all while evading Commission review of such actions. The Proposed Order fails to provide sufficient context or describe the issues and events in a way that would allow the public to understand what precipitated the ten-year long proceeding. More importantly, the Proposed Order virtually ignores substantial evidence that:

- Nicor manipulated the GCPP in 2001 by using the program to protect itself against risk of loss while simultaneously exposing its customers to record-high gas prices, to the tune of over $128 million.

- Nicor's use of hub services in the winter of 2001 inflated rates by $11 million. Despite claiming it was forced to buy gas on the market during an unprecedented price spike in January 2001, Nicor nonetheless withdrew 8 Bcf from storage in February and March 2001, which it then loaned to third parties instead of using that gas to displace market-priced gas in January.[1]

- By depleting significant stores of low-cost LIFO gas in storage and replacing it with higher-cost gas, Nicor increased base rates by $6.8 million per year since the higher gas costs went into base rates in September 2005, ($47.6 million to date).

- The calculation of the LIFO benefit in the Nicor-Staff Stipulation does not represent the entire value attributed to it by Nicor. An additional $2,128,066 refund is necessary to provide ratepayers with the entire value of the LIFO-derived savings.

The evidence in this proceeding overwhelmingly demonstrates that Nicor exploited the GCPP to its full advantage at every opportunity. The driving force behind the GCPP was

[1] This is precisely the activity Peoples Gas Light & Coke Company engaged in under its "Gas Purchase Agency Agreement" ("GPAA"), which the Commission concluded was imprudent. 01-0707 Order at 90-94.

Nicor's desire to capture the value of low-cost gas that had been on its books for decades (called "LIFO" gas layers, for the "last in, first out" accounting method). Nicor successfully exploited the GCPP to capture 50% of the benefit of this low-cost gas, when under traditional regulation 100% of the benefit would have accrued to ratepayers – a scheme Nicor took great pains to hide from the Commission. CUB Ex. 1.0 2nd Rev. at 22:571-582 (DRR to CUB 27); CUB Ex. 1.07 (DRR to CUB 1.17).

But Nicor did not stop there. The GCPP opened the door to further exploitation and manipulation of the program that did not consist of the type of "innovation" or "efficiency" on which the Commission based its conclusion that the program would produce "substantial and identifiable benefits" for Nicor's customers. *99-0127 Order* at 37. These same transactions were found to be improper by the Lassar Report and/or by witnesses from Staff and CUB, and form the basis for the $64 million Nicor agreed to refund to customers in the Nicor-Staff Stipulation:

- **Infield Transfers**: Nicor improperly accounted for in-field transfers as withdrawals under the PBR in order to manipulate the benchmark to produce more "savings" under the GCPP. CUB Ex. 1.02 (Lassar Report) at 55. The Company only tracked in-field transfers when doing so enabled the Company to compute and share in greater "savings" under the GCPP, which Staff witness Zuraski found was either a remarkable coincidence or evidence that the Company was ***manipulating the PBR benchmark***. *Id.* at 28:562-63, 33:686-87. CUB Witness Mierzwa similarly found that the netting of storage injections and withdrawals is a ***clear example of improper storage withdrawal manipulation***, because Nicor claimed that it could not manipulate storage withdrawals in Docket Nos. 96-0386 and 99-0127. CUB Ex. 1.0 2nd Rev. at 47:191-94.

- **Tennessee-Midwestern Contract:** ***Nicor misled the Commission*** in its oral argument before the ICC on November 2, 1999, in claiming that its Tennessee and Midwestern contracts were still being negotiated, when in fact the Company had already reached an agreement with Tennessee and Midwestern with respect to demand costs under the new contracts on October 18, 1999. CUB Ex. 1.0 2nd Rev. at 54:1481-1486. Nicor deliberately halted negotiations with Midwestern and Tennessee until Docket No. 99-0127 was almost over and resumed negotiations sometime after the HEPO was issued when no more evidence would

be entered into the record. Staff Ex. 2.0R at 25:475-78. By doing so, Staff testified, Nicor avoided inclusion of their newly-negotiated, lower rates in the FDA, ***making it easier for Nicor to meet the benchmark and create "savings."*** *Id*. at 27:506-511.

- **Affiliate Transaction:** On January 28, 2000, Nicor entered into a sale of gas to its affiliate, Nicor Enerchange, at a discount for future delivery of that gas in September and October. CUB Ex. 1.0 2nd Rev. at 58-59:1614-1641. To address concern about the "impression of impropriety" the transaction might suggest, Nicor also entered into two transactions with unaffiliated entities on the same day. *Id*., citing to Lassar Report at 69. The Company experienced a loss on this sale. *Id*. Staff found that the reason for this affiliate transaction was to increase "accounting" storage withdrawals to stay on schedule to beat the storage credit adjustment component of the benchmark. Staff concluded that, despite the Company's claims to the Commission in Docket No. 99-0127 that storage withdrawals were a function of weather and that the Company would not and could not manipulate storage withdrawals, ***in the very first month of the program, the Company was already busy manipulating withdrawals*** from an accounting standpoint. Staff Ex. 1.0R at 40:831-35.

- **Weather Insurance:** During the 2001 heating season, Nicor purchased weather insurance from Aquila at a substantially higher premium than the year before. To lower the premium paid, Nicor packaged the insurance product with a second transaction in which Nicor transferred gas to Aquila at a $2 million discount, in exchange for a like discount of the insurance premium. CUB Ex. 1.02 (Lassar Report) at 4. ***Nicor included the cost of this insurance product as a recoverable gas cost under the GCPP, which was improper (the Company's own employee, Leonard Gilmore, called the transaction imprudent)***. CUB Ex. 1.0 2nd Rev. at 1176-1180.

- **Capacity Management Credits:** Under the GCPP, the Firm Deliverability Adjustment ("FDA") component of the benchmark was meant to reflect the most recent 12-month actual experience of Nicor's interstate pipeline reservation charges. CUB Ex. 1.0 2nd Rev. at 55-56:1502-1537. Included in these charges were capacity management credits which reduced total reservation charges. In 1999, Nicor reduced its efforts to realize capacity management credits, and thus, for the years 2000 through 2002, under the GCPP, the FDA of the ***Benchmark was artificially inflated*** based upon the artificially-depressed figures from 1999. *Id*. at 57:1591-58:1593. Staff witness Maple testified that the FDA portion of the benchmark for 2000-2002 should have been lowered to reflect the higher level of capacity management credits that should have been "built into" the FDA but were not because of the artificially low capacity release credits in 1999. Staff Ex. 2.0R at 36:675-80. ***Because of Nicor's reduced efforts to realize capacity management credits in 1999, the GCPP Benchmark used from 2000-2002 was artificially inflated***.

- **Hub Revenues Adjustment:** Nicor did not consistently flow through revenues from transactions through the Chicago Hub (including services like parking and loaning of gas), as it was required to do pursuant to Commission Rules (83 Ill. Admin. Code Section 525.40(d)). Staff Ex. 1.0R at 48:968-975. Revenues from these transactions should have been included in the PGA as an offset to gas costs. *Id*.

In Docket No. 99-0127, in which the GCPP was established, the Company represented to the Commission that it would not do anything under the PBR to increase costs to ratepayers; that under the GCPP the interests of ratepayers and the Company were aligned; and the Company could not manipulate storage activity. *See* CUB Ex. 1.0 2nd Rev. at 48:1311-1327; *99-0127Order* at 15. But Nicor broke each of these promises and caused significant ratepayer harm, some of which is represented in the adjustments that comprise the $64 million refund in the Stipulation.

Despite initially calling for a $6 million reimbursement from ratepayers, Nicor has now ceased defending itself against the allegations relating to these claims and has agreed to refund $64 million in connection with its operation of the GCPP. However, this amount does not by any means represent the full extent of Nicor's exploitation of the GCPP, as the Proposed Order acknowledges – at least in part – by correctly finding that at least one additional adjustment should be adopted: the DSS Withdrawal adjustment made by Staff and CUB witnesses to account for 100% of the DSS volumes Nicor previously improperly excluded from the calculation of the storage credit adjustment component of the benchmark. CUB Ex. 1.0 2nd Rev. at 41:1133-1143.

The Proposed Order adopts the Stipulation based on substantial evidence that the adjustments were "reasonable and supported by the record in this proceeding," (PO at 4-6), as it must under prevailing Illinois law (discussed in Section II infra). The 2001 storage adjustment advocated by CUB Witness Mierzwa and AG Witness Effron is premised on the same essential

theory of the adjustments adopted by the Proposed Order – that Nicor lied about its intentions for the program, and took every opportunity to manipulate it to its advantage. Yet, the Proposed Order summarily dismisses the 2001 storage adjustment and the storage carrying charges adjustment with virtually no analysis.

Witnesses from CUB and the AG each presented detailed evidence refuting all of Nicor's consultants' claims and substantiating the called-for refunds for their 2001 storage manipulation adjustments. Nicor, however, did not rebut evidence of storage manipulation with testimony from employees involved in the operation and management of the GCPP at the time the events took place. Nicor's failure to proffer evidence from the individuals involved in the GCPP at the time of its operation represents a failure to meet its burden to refute these claims and is a glaring omission that casts serious doubt on the credibility of Nicor's case.

Furthermore, Nicor did not present a single witness to address the significant evidence produced by CUB, Staff and the AG that the Company misled the Commission in Docket No. 99-0127 with regard to its intent to exploit low-cost LIFO gas and its continued deception in the current docket (until the whistleblower fax came to light). Nor does the Company defend itself against this evidence in brief. If evidence indeed existed that would have been favorable to Nicor in rebutting the evidence that it hid the true purpose of the GCPP from the Commission, Nicor would have produced such evidence.

While, as noted above, this proceeding is very unique in many ways, it is very reminiscent of another gas cost proceeding in recent history – that of the 2001 Purchased Gas Adjustment ("PGA") proceeding of Peoples Gas Light & Coke Company ("PGL"). The similarities between the two dockets cannot be disputed. In Docket No. 01-0707, PGL used its affiliate, enovate, to artificially inflate costs borne by consumers in a manner that unfairly

conferred profits on its parent, Peoples Energy Corporation (now Integrys Energy Services), as well as other PGL affiliates, and its partner, Enron North America Corp. *Illinois Commerce Commission On Its Own Motion vs. Peoples Gas Light and Coke Company*, Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred, Docket No. 01-0707, Order at 19 ("*01-0707 Order*"). In order to effectuate these profits, PGL's affiliates utilized PGL's storage assets. *Id*. Similarly, Nicor sought approval of its GCPP in order to exploit its storage assets for shareholder profit by capturing the value of low-cost LIFO gas layers in storage.

In the *01-0707 Order*, the Commission approved an extensive settlement that included $100 refund to each of PGL's approximately 823,000 customers at the time of the refund[2] (compare to the Proposed Order's total recommendation of $72 million, which, spread between Nicor's ***2.2 million*** customers, would only result in a one-time refund of less than $33). The Commission's 01-0707 Order included substantial analyses and thorough, well-reasoned conclusions that evaluated each piece of evidence presented by the parties. In addressing the overall scheme PGL and its affiliates engaged in, the Commission described its reaction in the following way:

> The Commission believes PGL's actions during this reconciliation period move beyond mere imprudence to being egregious. PGL entangled itself in a clever corporate web with its parent company, its affiliates and Enron designed to use PGA assets, assets designated to serve PGL's ratepayers, solely for the gain of the entities involved.
>
> At the center of this web lay enovate, a shell of a company that existed only as a rest stop for profits on their way to PEC/PERC and Enron's coffers. PGL's attempts to explain its involvement not only failed, but actually worked against it. PGL flouted the law and Commission rules, completely disregarded its duty to its PGA customers and jeopardized its credibility. Over the next few years,

[2] See *01-0707 Order*, Attachment A at 1.

the Commission intends to closely scrutinize PGL through the audits agreed to in the Settlement Agreement and Addendum (discussed below) in hopes that its conduct during this reconciliation is an aberration.

The Commission notes that over four years have passed since this reconciliation proceeding commenced on November 7, 2001, for the October 1, 2000 through September 30, 2001, period in question. While the Commission believes that a proceeding's duration must be congruent to due process assurance, we believe that PGL's conduct, in exercising its due process rights, unnecessarily lengthened this proceeding.

Moreover, at various times, PGL was not completely responsive to intervener requests. Particularly stunning is that PGL, throughout initial discovery, denied the existence of vital information about its alleged affiliate business dealings and about the GPAA contract that later was revealed more fully in re-opened discovery. Were it not for the fact that a FERC database contained pertinent information about Enron's relationship with PGL and PGL's affiliates and that information —mined by Staff and the GCI from an avalanche of subsequently tendered paper and electronic documents—provided important details on those relationships, this Commission may never have fully ascertained the basis for and the extent of these agreements and transactions that conferred profits to PGL's corporate parent, PEC, and to Enron NA at ratepayer's expense.

Further, PGL engaged in certain agreements and transactions with enovate and Enron MW that were designed to evade Commission detection. That PGL proceeded in these affiliate interest agreements and transactions without prior Commission approval is an astonishing disregard for and circumvention of the Public Utilities Act and Commission rules.

When viewing the record in its totality, the Commission finds that PGL's conduct is not only imprudent, but it also is egregious. People's Energy and Enron developed a strategic partnership that diverted revenues from the regulated utility PGL to its unregulated parent company, PEC, and its unregulated subsidiaries, along with Enron NA, with no corresponding benefit to PGA customers that PGL serves. This strategic partnership used PGL's PGA assets—including gas, contract storage, and Manlove Field operations—and PGL performed transactions and engaged in activities with either enovate, Enron MW, or Enron NA that increased customer gas costs while increasing profits for PGL's parent company, PEC.

> In sum and substance, revenues were diverted from ratepayers to Peoples Energy and the unregulated affiliates and to Enron. Those revenues should have gone to ratepayers as an offset to the gas costs that they were actually charged.
>
> *****
>
> The Commission's finding of imprudence is not the only result of PGL's imprudent and egregious conduct during this reconciliation period. The Commission's confidence in PGL's management to be forthright and fair in serving ratepayer interests and in dealing with this Commission is shaken. The Commission believes that its regulatory compact with PGL, its presumption of good faith on the part of PGL's management, and PGL's overall integrity as a corporate citizen is severely damaged by the instant case.

01-0707 Order at 138-140. This is exactly the type of analysis and conclusion that is sorely missing from the Proposed Order, considering Nicor's actions caused greater financial harm[3], broke more regulatory promises, and similarly lacked good faith and integrity.

The similarities between PGL's GPAA and Nicor's GCPP are uncanny. Here, like PGL, Nicor intentionally concealed vital information from the Commission in Docket No. 99-0127, and continued the deception in the instant dockets. CUB Exhibit 2.0 Rev. at 7:144; CUB Exhibit 1.0 2nd Rev. at 26:713-15; Staff Ex. 1.0R at 5:102-104. It is undisputed that the Company failed to reveal its intentions to access LIFO layers to the Commission in the docket approving the GCPP (ICC Docket No. 99-0127), even when specifically requested to do so (CUB Ex. 1.03). Yet, it was later revealed that Nicor had assembled an "Inventory Value Team" – before the GCPP was filed – for the very purpose of identifying methods to exploit the value of this low-cost gas, concluding that a PBR mechanism was the way to accomplish this goal. Additionally, a presentation to Nicor's Board of Directors made in 1998 shows unambiguously that if the

[3] Compare the total refund recommended by CUB, the AG and the City of Chicago in Docket No. 01-0707 of about $100 million (see CUB/City/AG Joint Initial Brief at 3), and the Docket No. 01-0707 Proposed Order's recommendation of $127,570,096, (see Docket No. 01-0707, Sept. 20, 2005 Proposed Order at 133), to CUB's and the AG's recommendations in this proceeding of well over $200 million.

Company was not able to exploit the value of the LIFO gas through the PBR mechanism, the PBR would have been too risky. CUB Ex. 1.04 at 4.

Beyond just accessing low-cost LIFO gas, and lying to the Commission about that driving intention of the GCPP, substantial evidence in this proceeding demonstrates that the Company repeatedly took advantage of the severely reduced regulatory oversight under the GCPP to conduct improper transactions that increased the cost of gas, including the eight transactions included in the Nicor-Staff Stipulation that Nicor now no longer contests. In addition to, for example, using infield transfers to manipulate storage withdrawals, conducting improper affiliate transaction with Nicor Enerchange, and inflating the benchmark by reducing capacity management credits, CUB Witness Mierzwa and AG Witness Effron also each independently concluded, relying on extensive evidence, that Nicor physically manipulated its storage withdrawals to affect the benchmark in 2001. Considering the substantial evidence demonstrating the manipulation of the GCPP outlined above, issues that the Company no longer contests and the Proposed Order accepts as "supported by the record," (see PO at 4-6), it is reasonable to conclude the Company also manipulated storage withdrawals in 2001, as shown by Messrs. Mierzwa and Effron.

The 2001 storage adjustment recommended by CUB Witness Mierzwa and AG Witness Effron is just one more example of Nicor's exploitation of the GCPP to its advantage. The evidence in this proceeding incontrovertibly shows that Nicor manipulated its storage withdrawals during 2001 to 1) access additional LIFO layers, and 2) track the storage credit rate to minimize loss under the benchmark. CUB Ex. 1.0 2nd Rev. at 51:1403-52:1432. In 2001, the Company also provisioned hub services, which reduced the amount of gas in storage to deliver to

sales customers, precisely what the Commission found imprudent in its *01-0707 Order* (*01-0707 Order* at 90-94).

The evidence further demonstrates that by exploiting the large stores of low-cost LIFO inventory, Nicor was forced to add gas to its inventory at a substantially higher cost, which perpetually raised Nicor's base rates by $6.8 million per year. Not only did witnesses from CUB and the AG provide ample evidence showing how Nicor's actions increased costs to ratepayers in contravention of the Commission's finding that the program was "likely to lower gas costs for Nicor's customers," (99-0127 Order at 39), but Nicor failed to meet its burden of proof with respect to its operation under the GCPP. In order to do justice to the extensive ratepayer harm that Nicor's actions caused, CUB respectfully requests that the Commission adopt the Exceptions identified in the attachment to this Brief on Exceptions for the reasons stated herein.

II. RELEVANT LEGAL STANDARDS

The GCPP was filed by the Company as an alternative regulation plan under Section 9-244 of the PUA, which spells out the specific findings the Commission must make in order to approve an alternative regulation proposal. 220 ILCS 5/9-244(b). Under Section 9-244(b), the Commission must find that an alternative regulation program meets the following criteria:

> (1) the program is likely to result in rates lower than otherwise would have been in effect under traditional rate of return regulation for the services covered by the program and that are consistent with the provisions of Section 9-241 of the Act; and
>
> (2) the program is likely to result in other substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program; and

> (3) the utility is in compliance with applicable Commission standards for reliability and implementation of the program is not likely to adversely affect service reliability; and
>
> (4) implementation of the program is not likely to result in deterioration of the utility's financial condition; and
>
> (5) implementation of the program is not likely to adversely affect the development of competitive markets; and
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> (6) the electric utility is in compliance with its obligation to offer delivery services pursuant to Article XVI; and
>
> (7) the program includes annual reporting requirements and other provisions that will enable the Commission to adequately monitor its implementation of the program; and
>
> (8) the program includes provisions for an equitable sharing of any net economic benefits between the utility and its customers to the extent the program is likely to result in such benefits.

In its *99-0127 Order*, the Commission made each of these findings based on a record we now know was fraught with misinformation and misrepresentations from Nicor.

Under Section 9-244(c), the Commission is required to conduct a review of the GCPP after two years of operation to determine whether the GCPP was meeting its objectives. On January 24, 2002, the ICC initiated Docket No. 02-0067 to review the GCPP as required by the Act. Testimony was filed, discovery conducted and an evidentiary hearing was held in Docket No. 02-0067 on June 10, 2002. At the close of the hearing, the record was marked "Heard and Taken." After the whistleblower fax came to light, however, the course of this proceeding took a sudden and dramatic turn. Pursuant to a joint motion of all parties to this proceeding, the record was reopened, extensive discovery was conducted, and, in its Second Interim Order, the Commission expanded the scope of the statutory Section 9-244 review as follows:

> The Joint Motion states that given the arguably limited scope of the proceeding as originally defined in the portion of the ordering paragraph quoted above, it would be appropriate for the

> Commission to clarify that this proceeding is the appropriate formal mechanism to consider the totality of issues currently before this Commission as a result of the operation of the Program, including the transactions occurring in 1999. The Joint Motion further states that given the possibility that Section C of Rider 4 will be canceled along with the remainder of that Rider effective January 1, 2003, it is further necessary to specify that issues related to the operation of that tariff provision be preserved for any action determined by the Commission to be necessary.
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> **********
>
> IT IS THEREFORE ORDERED that the record in this proceeding shall be fully re-opened, that it will consolidate this proceeding with Dockets 01-0705 and 02-0725, and that it will consider for final resolution in this proceeding all issues relating to the operation of the Program Nicor Gas implemented under tariffs filed in accordance with the Commission's Order entered November 23, 1999, in Docket 99-0217, **and all issues relating to any refunds that may be owing to Nicor customers as a result of the operation of the Program** and as a result of the operation of the Company's Rider 6 in 1999, 2000, 2001, and 2002, and for ordering such other and further relief as deemed equitable and just.

Second Interim Order at 6 (December 17, 2002) (emphasis added). The purpose of this docket at this point, therefore, is to determine the appropriate amount of refunds owed to ratepayers as a result of the improperly-operated GCPP. CUB and the AG continue to contend that the $64 million Nicor-Staff Stipulation does not take into account significant additional ratepayer harm.

The Nicor-Staff Stipulation is a non-unanimous settlement, because neither CUB nor the AG is a party to the Stipulation, and does not resolve all contested issues in this proceeding. The Illinois Supreme Court addressed the standard for the Commission's approval of settlement agreements and for consideration and adoption of proposed settlement agreements in *Bus. and Prof'l People for the Pub. Interest*, 136 Ill. 2d 192, 217 (1989) ("*BPI I*"). *BPI I* holds that the Commission may consider a non-unanimous settlement in making a decision on the merits, as long as the provisions of the proposal are within the Commission's power to impose, do not

violate the PUA, and are independently supported by substantial evidence in the whole record. *Id.*

As the Commission has previously noted, the requirements expressed in *BPI I* are similar in substance to the standards found in section 10-201 of the PUA that apply generally to the judicial review of Commission orders and decisions. ICC Docket No. 07-0566, Final Order of September 10, 2008 at 11. Therefore, the Commission must make independent findings on each of the issues to determine whether the Settlement is supported by substantial evidence in the record. Substantial evidence is more than a scintilla, but less than a preponderance. *Citizens Utility Board v. Illinois Commerce Commission,* 291 Ill. App. 3d 300, 304 (Ill. App. Ct. 1997). This requires the Commission to demonstrate that facts exist that sustain the findings and ordering paragraphs of an order that would adopt, as a resolution on the merits, the provisions of the proposed Settlement. CUB and the AG each argue that the $64 million refund agreed to in the Nicor-Staff Stipulation is not sufficient to resolve the contested issues in this proceeding, because it ignores substantial ratepayer harm that resulted from transactions not reflected in the Stipulation.

Finally, and most importantly, the Proposed Order fails to even mention the most fundamental legal threshold: the burden of proof. Unequivocally, the burden of proof in this proceeding lies with *Nicor* – not Staff or CUB or the AG. 220 ILCS 5/9-201(c) ("the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility"). Nor does the Proposed Order mention the standard of proof applicable to this proceeding. The Illinois Administrative Procedure Act ("APA") defines the standard of proof by which Nicor must meet its burden under the Public Utilities Act. The APA provides that:

"unless otherwise provided by law or stated in the agency's rules, the standard of proof in any contested case … shall be the **preponderance of the evidence**." 5 ILCS 100/10-15 (emphasis added). The Commission has confirmed that the APA's standard governs its proceedings. *Ill. Commerce Comm'n v. Commonwealth Edison Co.*, 155 P.U.R. 4th 17, 53 (1994) ("preponderance of evidence at the hearing level has long been the standard by which this Commission has determined matters before it").

This is not a murder case and the standard of proof is not "beyond a reasonable doubt." Rather, under Illinois law, a preponderance of the evidence means "more probably true than not," *Holton v. Memorial Hospital*, 176 Ill. 2d 95, 105 (1997), or is demonstrated by evidence that renders a fact "more likely than not." *Lindsey v. Bd. of Educ.*, 354 Ill. App. 3d 971, 986 (1st Dist. 2004); *see also* Restat. 2d Torts §433B cmt. a. That determination must be made on the basis of the entire record, not merely the evidence presented by the utility. Thus, Nicor has the burden to prove that the GCPP was meeting the objectives outlined by the Commission in the docket approving the program, Docket No. 99-0127, by a preponderance of the evidence. 5 ILCS 100/10-15. Based on the record before the Commission, Nicor utterly failed to meet its burden of proof.

III. EXCEPTIONS

A. EXCEPTION #1: 2001 Storage Adjustment

The Proposed Order ignores substantial evidence demonstrating that the Company manipulated its 2001 storage withdrawals to affect the benchmark to its benefit and to the detriment of ratepayers, (CUB Ex. 1.0 2nd Rev. at 47:1298-53:1458; CUB Ex. 2.0 Rev. at 27:621-45:1007). Several indisputable facts support this finding:

1) Nicor did not fill its contract storage in 2000, so had 17.5 Bcf less gas in storage going into the 2000-2001 heating season than during prior years. CUB Ex. 2.0 Rev. at 40:890; CUB Init. Br. at 54; CUB Reply Br. at 25.

2) The colder-than-normal weather experienced in November 2000 caused Nicor's sales to increase only by 3.7 Bcf (rebuttal at 767), yet Nicor increased November 2000 storage withdrawals by 11.2 Bcf over planned levels NOT to meet the increase in sales due to cold weather, but to avoid the adverse consequences which it would have experienced under the GCPP. CUB Ex. 2.0 Rev. at 36:804; CUB Init. Br. at 50; CUB Reply Br. at 29.

3) Because Nicor failed to fill its NGPL storage prior to the winter of 2000-2001 and had significantly increased storage withdrawals in November 2000 to avoid adverse consequences under the GCPP, its storage inventories were significantly reduced and its ability to withdraw gas from storage in January was significantly diminished; CUB Init. Br. at 52-3; CUB Reply Br. at 21.

4) Nicor accessed an additional 17.5 Bcf of LIFO gas in 2000.[4] CUB Reply Br. at 21.

5) Because January 2001 storage withdrawals were significantly reduced and it was in Nicor's interest to follow the injection and withdrawal percentages in the storage credit adjustment component of the GCPP benchmark, Nicor substantially reduced storage withdrawals during 2001 to a level less than one-half of the year before (2000) and about 60% of the year after (2002). CUB Init. Br. at 53-54; CUB Reply Br. at 21.

6) Nicor's severely reduced storage withdrawals in 2001 reduced the storage credit rate component of the benchmark, thereby increasing the benchmark, and created false "savings." CUB Init. Br. at 56; CUB Reply Br. at 27.

7) Nicor's severely reduced storage withdrawals in 2001 forced the utility to buy market-priced gas during an unprecedented price spike, and passed those high gas prices on to customers. CUB Init. Br. at 56; CUB Reply Br. at 27.

8) While prices were high in February and March 2001, Nicor withdrew 8.0 Bcf of gas from storage and loaned it to third-parties rather than using it to serve and reduce costs to its ratepayers to avoid adverse consequences to it under the GCPP. CUB Init. Br. at 56; CUB Reply Br. at 27.

Nicor could not refute these points, each of which support the 2001 storage adjustment. CUB will not attempt to repeat each argument in its Initial and Reply Briefs, but incorporates them herein by reference, and presents here the most critical pieces of evidence supporting CUB's

[4] Nicor is able to access LIFO gas when current year end storage inventories are less than the prior year's year end storage inventory.

$128 million adjustment to account for Nicor's manipulation of storage during 2001. CUB Init. Br. at 57; CUB Reply Br. at 20-32.

1. Nicor Reduced Its Storage Withdrawals in 2001 to Manipulate the Benchmark, Despite Claiming It Could Not and Would Not Do It

In Docket Nos. 96-0386 and 99-0127, the Company claimed it could not manipulate storage, even in the face of Staff's concern and claim in Docket 99-0127 that the SCA could give the Company an incentive to create false savings by shifting withdrawals to months when Market Index Prices were low, and meet demand with current purchases when Market Index Prices are high. ICC Docket No. 99-0127 Order at 15. Staff argued that the Company could reduce the Storage Credit Rate and raise the Benchmark, thereby enabling the Company to share in greater "savings" or fewer "losses." *Id*. The net result, Staff posited, could be an increase in the cost of gas to ratepayers. *Id*. That is precisely what happened. CUB Init. Br. at 42-45.

In Docket Nos. 96-0386 and 99-0127, the Company claimed that storage withdrawals were a function of weather and operational requirements and claimed that it could not manipulate storage to its benefit under the GCPP. CUB Ex. 1.0 2nd Rev. at 47:1300-48:1306. Though the Company steadfastly denied that it could shift withdrawals to manipulate the benchmark, it did just that in 2001. This is the genesis of Mr. Mierzwa's and Mr. Effron's 2001 storage withdrawal adjustments. In Docket Nos. 96-0386 and 99-0127, the Company and its witnesses made the following statements:

> **Witness Edwin Werneke**:
>
> On the other hand, the Company has very limited ability to adjust the timing of storage withdrawal volumes, which are determined largely by weather and operational requirements.
>
> (Docket No. 99-0127, Direct at 10).
>
> **Witness Edwin Werneke**:

> Second, Mr. Mierzwa apparently believes that the Company has wide discretion with respect to its storage injection and withdrawal cycle, and can therefore accelerate or defer gas purchases at will. In fact, the Company's discretion with respect to inter-month storage injections and withdrawals is limited, reflecting the physical characteristics of the Company's aquifer storage fields and contractual limitations on purchased storage.
>
> (Docket No. 96-0386, Rebuttal at 3).
>
> **Witness Leonard Gilmore**:
>
> The Company cannot shift inventory withdrawals without impacting its design peak day capabilities and overall storage field performance. Consequently, even if the Company could predict prices such that it could gain from shifting withdrawals, it would be a bad business decision for the Company to do so…
>
> (Docket No. 99-0127, Surrebuttal at 4).
>
> Nicor states…it has very limited ability to adjust the timing of storage withdrawals, which are largely determined by weather and operational requirements and therefore cannot be manipulated.
>
> (*99-0127 Order* at 8).

CUB Ex. 1.0 2nd Rev. at 48-49:1311-1339. In 2001, however, Nicor reduced its 2001 storage cycle (reduced the amount of gas withdrawn from storage) due to concerns related to its performance under the PBR. At the time of that decision, it was not in the best interest of ratepayers to lower the storage withdrawal cycle because the cost of current purchases exceeded the projected costs of replacement supplies. CUB Ex. 1.0 2nd Rev. at 52:1426-1432; CUB Ex. 1.17. Because of the reduced withdrawal cycle, Nicor was then forced to buy additional gas at market prices to serve its customers during a record price spike in January 2001, and also during February and March 2001 when prices were historically high. CUB Ex. 1.0 2nd Rev. at 51:1403-1408, citing CUB Ex. 1.14.

In rejecting the 2001 storage adjustment proposed by both Mr. Mierzwa and Mr. Effron, the Proposed Order appears to cite to the fact that the Company followed the established withdrawal percentages approved in Docket No. 99-0127 for the premise that this was indicative of proper operation under the GCPP. PO at 17. The Proposed Order, however, misses the relevant points entirely:

(1) Storage withdrawals were reduced in January 2001 and the remainder of 2001 because Nicor failed to fill its NGPL storage to historic levels prior to the winter of 2000-2001 to access LIFO gas, and because Nicor significantly increased storage withdrawals in November 2001. Nicor was not following the established withdrawal percentages when it did so. CUB Init. Br. at 52-54; CUB Reply Br. at 20-21.

(2) In order to follow the established withdrawal percentages, Nicor had to shift withdrawals in 2001. This is exactly what Nicor assured the Commission it could not and would not do in response to Staff's concerns about its ability to influence the benchmark in Docket No. 99-0127, as indicated above. But Nicor did it anyway in order to access LIFO gas and avoid adverse consequences under the GCPP and by following those percentages in 2001, Nicor exposed its ratepayers to record high gas prices. In approving the GCPP, the Commission dismissed Staff's concerns, in part because the program would be subject to review after two years. *99-0127 Order* at 37. By reducing its storage withdrawals to match the SCA percentages and consequently raise the benchmark, Nicor increased ratepayers' gas costs by approximately $128 million before interest is applied ($155 million less approximately $27 million of LIFO benefit, had Nicor not accessed 17.5 Bcf of LIFO gas). CUB Init. Br. at 4, 54; CUB Reply Br. at 3, 5-6, 27.

(3) The withdrawal percentages under the storage credit adjustment were based on Nicor's historic withdrawal activity during the years 1994 – 1998. The Proposed Order implies that Nicor was doing nothing differently than what it had historically been doing. There is nothing further from the truth. During the period 1994 – 1998 the lowest quantity of gas withdrawn from storage by Nicor was 115 Bcf (Direct at 1455). During 2001, 66 Bcf was withdrawn (Direct 1456). It was hardly business as usual. CUB Init. Br. at 48.

The Lassar Report confirms that Nicor planned a greatly reduced storage cycle in 2001 in an attempt to beat the storage component of the Benchmark. CUB Ex. 1.02 at 52, Note 24. Nicor had planned to reduce its 2001 withdrawal cycle as early as January 2001 and did this so it could "match its withdrawals to the SCR weightings." *See Id.* By matching its withdrawals to

the SCR, Nicor would limit its risk of underperforming against the storage component of the benchmark (*Id.*) – the only component over which the Company had any control. Once the January 2001 storage withdrawal level was set at this reduced level, Nicor followed the monthly inventory withdrawal percentages used to develop the SCA, resulting in a reduced storage withdrawal cycle throughout 2001. CUB Init. Br. at 47-48; CUB Reply Br. at 21-22.

Nicor's storage withdrawals in winter 2001 were substantially lower than the previous four years. The table below summarizes Nicor's winter storage withdrawal activity for the period 1994 through 2001. Nicor's monthly storage activity during the period 1994 through 1998 was used to determine the monthly storage injection and withdrawal percentages reflected in the Storage Credit Rate:

Table 1-R
Nicor Gas Company
Monthly Withdrawals
(Bcf)

Winter Season	Nov.	Dec.	Jan.	Feb.	March	Total
1994-1995	10.8	19.6	33.8	33.3	16.8	114.3
1995-1996	14.4	20.3	30.3	20.9	15.8	101.7
1996-1997	19.1	21.0	38.2	24.5	21.0	123.8
1997-1998	12.6	22.8	27.8	20.8	21.9	105.9
4-Year Average	14.2	20.9	32.5	24.9	18.9	111.4
1998-1999	11.3	19.9	25.7	23.3	29.2	109.4
1999-2000	12.5	20.1	25.4	18.9	16.6	93.5
2000-2001	25.4	21.1	17.8	8.9	7.8	81.0

CUB Ex. 2.0 Rev. at 720-721. In fact, the Company's total withdrawals during 2001 were less than half the average withdrawals in the years 1994-1998 (withdrawals in 2001 were 54.3 million MMBtus, which was 69 million below the average of 123.3 million MMBtus in 1994-1998). AG Ex. 1.2 at 24:16-22.

Storage operations generally follow a seasonal pattern wherein the months of April through October are considered storage injection months, and the months of November through March are considered storage withdrawal months. CUB Ex. 2.0 Rev. at 32:726-733; CUB Init.

Br. at 49-51. Therefore, an appropriate initial starting point for an investigation of Nicor's 2001 storage withdrawal activity would be November 2000. *Id.* Nicor regularly monitored its performance under the SCA component of the Benchmark, including the Storage Credit Rate. Nicor also monitored on a daily basis its performance under the Market Index Cost calculation, including the impact of daily changes in natural gas prices. CUB Ex. 2.0 Rev. at 31:707-711, citing CUB EX. 1.15, CUB EX. 2.07. In a month of rising prices, Nicor's PBR Purchasing Guidelines indicated that the Company should buy less gas. In CUB EX. 2.08, there is a difficult to read hand written note on the document entitled "PBR Sales Calculation-Plan vs. Forecast - November" which states: "Strategy - Continue to drop GDD as long as prices stay above FOM. If believe prices ↓ from FOM, then look to sell off ROM." CUB Ex. 2.0 at 35:780-796. In the note, GDD is a reference to daily purchases and "ROM" refers to rest of month purchases. *Id.* By reducing daily purchases in a month with rising prices, Nicor stood to gain a benefit under the PBR. *Id.* As shown in CUB Ex. 2.09, Nicor significantly decreased and eventually eliminated its daily priced purchases toward the end of the month. *Id.*

Nicor withdrew 25.4 Bcf from storage in November 2000, an increase of approximately 11.2 Bcf, or nearly 80 percent, over planned withdrawals and the historic average level of November withdrawals. CUB 2.0 Rev. at 36:800-806; CUB Init. Br. at 51-52. In the Company's final December 2000 monthly gas supply plan, planned on-system storage withdrawal volumes were 14.7 Bcf, and DSS withdrawals were planned at 5.4 Bcf, for a total planned December 2000 withdrawal quantity of 20.1 Bcf. *Id.* at 37:817-820. In December 2000, severe cold weather significantly increased sales above planned levels. *Id.* at 37:822-826. As indicated by the response to CUB 20.06, actual sales were 11.6 Bcf higher than projected sales of 45.0 Bcf. *Id.* In addition, gas prices increased significantly during the month, from a FOM

index price of $5.58 per Dth to daily prices as high as $15.70 per Dth, with an average daily price of $9.67 per Dth. *Id*.

In December 2000, however, Nicor did not reduce its daily gas purchases and increase its storage withdrawals as it did in November 2000. *Id*. at 36:830-836; CUB Init. Br. at 52. Nicor's actual storage withdrawals were 21.1 Bcf, a level nearly identical to that reflected in the December 2000 monthly supply plan (20.1 Bcf), and the historic four-year 1994-1998 average (20.9 Bcf). *Id*. Nicor claims that weather and operational concerns limited its ability to withdraw significantly more gas from storage in 2001, because the Company had increased withdrawals in November 2000 by 11.2 Bcf more than planned (which was in excess of historic levels), and therefore depleted storage inventory levels. Nicor Ex. 10.0 at 6:114-119. But it was not Nicor's o*n-system* storage that caused Nicor to lower its 2001 storage cycle, but its *contract storage* inventory. CUB Ex. 2.0 at 42:944-952. Nonetheless, despite the fact that December 2002 inventory levels were even lower than in December 2000, Nicor's total storage withdrawals in 2003 were nearly twice as high as 2001. Nicor's story simply fails to add up.

2. Nicor Significantly Reduced Contract Storage Purchases to Access Additional LIFO Layers

The evidence in this proceeding clearly demonstrates that the Company's chief goal of the PBR was to access low-cost LIFO storage inventory. See. CUB Ex. 1.02 (Lassar Report); CUB Ex. 1.04 (Post Board of Directors Presentation); CUB Init. Br. at 52-54. In order to access LIFO inventory, storage withdrawals during a particular calendar year must exceed storage injections. *Id*. One way to accomplish this was Nicor's use of storage "pre-fills" – an accounting mechanism used to move stored gas off Nicor's books, and found to be improper by the Lassar Report. CUB Ex. 1.02 (Lassar Report) at 63. Another way to access LIFO inventory is to reduce storage inventory by reducing storage injections. Storage inventories are generally

at their highest level at the end of October, which is typically considered the beginning of the storage withdrawal season. CUB Ex. 2.0 Rev. at 39:874-40:889. As shown in the following table, Nicor's average NGPL contract storage volumes at the end of October averaged nearly 32 Bcf during the four-year period 1995-1998, and the end of December volumes averaged 26 Bcf for the same period: *Id*.

Table 3-R
Nicor Gas Company
Comparison of NGPL Contract Storage Inventory (Bcf)

	October	December
1995	32.0	32.4
1996	32.8	23.9
1997	32.0	23.8
1998	30.5	24.4
Average	31.8	26.1
2000	**14.3**	**5.9**

CUB Ex. 2.0 Rev. at 40:890-891. As this table shows, Nicor's NGPL contract storage in October 2000 was less than half the four-year average and its contract storage as of December 2000 was less than one-fifth of the four-year average. Storage inventory levels were depleted, therefore, not because of a nationwide trend to reduce storage injections, as Nicor contends, (Nicor Init. Br. at 33), but rather because Nicor failed to fill NGPL *contract storage* in the summer of 2000. *Id*.

Nicor further claims that the colder-than-normal weather in November and December 2000 caused it to significantly deplete its storage inventory, and the Company was not in a position to withdraw the same volumes in January 2001 as it had in previous years. Nicor Ex. 5.0R at 18:329-21:406; CUB Init. Br. at 54-55. Nicor maintained its storage inventory well below historic levels long before cold weather arrived in November – and continued its lower withdrawals even after its storage inventories returned to normal. Thus, while it is true that

Nicor's storage levels at the end of 2000 were reduced, it was not because of weather: it was because Nicor reduced its contract storage.

Nicor Witness Carpenter, who addressed this issue at length in testimony, could not offer an explanation as to why Nicor's NGPL contract storage inventory was below the historic average because he did not investigate the level of NGPL storage inventory. March 1 Tr. at 1407:3-10; CUB Cross Ex. 1; CUB Reply Br. at 22-23. Furthermore, Nicor did not present any witnesses who were gas operations employees directly responsible for the implementation and operating of the PBR. As a consequence, Nicor did not present evidence regarding the actions of its employees during the time the PBR was in operation to justify Nicor's decision to reduce NGPL storage inventory. Nonetheless, not even Nicor disputes that its NGPL contract inventory was significantly below historic levels, and that if NGPL inventory levels were higher, Nicor could have withdrawn more gas from storage in January 2001. March 1 Tr. at 1403:21–1403:10.

The evidence in this record shows that Nicor reduced its contract storage in fall of 2000 in order to access additional LIFO layers. Storage inventories are generally at their highest level at the end of October, which is typically considered the beginning of the storage withdrawal season (Ex. 2.0, 39:876–878), a premise with which Nicor Witness Carpenter agreed. March 1 Tr. at 1403:21–1404:6; CUB Init. Br. at 53-54. Mr. Carpenter also agreed that at the end of October 2000, Nicor's NGPL storage inventory was 17.5 Bcf below Nicor's historic average. *Id*. at 1401:1-6. Witness Carpenter further agreed that in 2000, Nicor accessed 17.5 Bcf of low-cost LIFO inventory gas. *Id*. at 1412:15–18. LIFO inventory is accessed when inventory levels at year's end are below that of the prior year. There is an obvious correlation, therefore, between Nicor maintaining NGPL inventory at a level 17.5 Bcf below historic levels and accessing 17.5 Bcf of low-cost LIFO inventory.

3. Nicor's Provision of Hub Services in 2001 Increased Gas Costs by $11 million

In the winter of 2001, Nicor engaged in Hub Services, which included firm and interruptible transportation and storage services, and park and loan services. CUB Ex. 2.0 Rev. at 43:954-965; CUB Init. Br. at 55-57; CUB Reply Br. at 27-290. Under a park transaction, a third-party delivers gas to Nicor at one point in time and that gas is returned to the third-party at a future point in time. *Id*. A loan transaction is just the opposite, with Nicor delivering gas to the third-party at one point in time and the third-party returning that gas to Nicor at a future point in time. *Id*.

During the summer of 2000, Nicor accepted 13.7 Bcf of gas from third-parties, injected that gas into its on-system storage facilities, and withdrew and returned that gas to third-parties by approximately mid-February 2001. CUB Ex. 2.0 Rev. at 44:971-980. Thus, 13.7 Bcf of storage on-system was unavailable to serve sales customers during the winter of 2000-2001. *Id*. In addition to already having returned 13.7 Bcf to third-parties, Nicor loaned an additional 8.0 Bcf of sales customers' gas to third-parties during February and March 2001, all the while reducing the storage withdrawal cycle to match the storage credit date percentages, and increasing the gas costs of sales customers. *Id*.

Nicor's provision of Hub services therefore reduced the amount of storage inventory available for sales customers for two reasons. First, because Nicor was required to return 13.7 Bcf of gas to third-parties during the winter of 2000-2001, Nicor's storage inventory was reduced by this amount and this contributed to the reduced storage withdrawal quantities during January 2001. *Id*. at 44:982-987. As a result, Nicor was required to purchase much more expensive gas to serve its sales customers than would have been necessary absent the obligation to return the gas to third-parties. *Id*. Second, because of low storage inventory levels which

existed just prior to January 2001, Nicor established its 2001 storage withdrawal cycle at a substantially reduced 60 Bcf. CUB Ex. 2.0 at 44:971-45:999. Because Nicor adjusted storage withdrawals to match the percentages in the Storage Credit Rate calculation, it reduced storage withdrawals in 2001 to serve sales customers. Simultaneously, however, during February and March 2001, Nicor loaned 8 Bcf of storage gas to third parties. *Id*. Thus, Nicor could have withdrawn more gas from storage to serve sales customers, and if it had, the additional withdrawals would have reduced gas costs for Nicor's sales customers by $11 million. *Id*.

It bears repeating that this is exactly the type of storage activity the Commission found imprudent in its 01-0707 Order, concluding that

> The Commission finds it difficult to believe that PGL could not have interrupted its third-party contractual obligations to honor its obligations to consumers, had it so chosen. PGL's decisions to position third-party requests before the needs of consumers placed PGL in the undesirable position of being required to buy large quantities of replacement gas at higher prices. In turn, PGL passed these imprudently incurred costs on to PGA customers
>
> *****
>
> The issue here is not where the replacement gas came from. Rather it is what consumers were required to pay as a result of PGL's decision to use its *consumer* "hedge" for third-parties.

01-0707 Order at 92. The Commission determined that PGL's use of hub services was imprudent. Nicor's decision to loan 8 Bcf of gas to third parties in February and March 2001 was similarly unreasonable in the face of already-reduced withdrawals at that time. Thus, if the Commission rejects CUB's and the AG's 2001 storage adjustment, an adjustment of at least $11 million is required to remedy the harm that resulted from Nicor's use of hub serviced during 2001.

4. Nicor's Failure to Produce Credible, First-Hand Testimony in Response to Allegations of Storage Manipulation Infers that No Such Evidence Exists

Under Illinois law, the Commission as the trier of fact in this proceeding may draw an inference that Nicor's failure to produce a witness with firsthand knowledge of the GCPP indicates that such a witness, if produced, would not corroborate the Company's defense. The Illinois Supreme Court has ruled that a trier of fact can draw an inference, when a party has failed to produce evidence within its power to produce, that this evidence if produced would be adverse to that party. (*Schaffer v. Chicago and Northwestern Co.*, 129 Ill. 2d 1, 25-26, 541 N.E.2d 643 (1989)). This inference may be drawn only when: a.) the evidence was under the party's control and could have been produced through reasonable diligence; b.) a reasonably prudent person would have offered the evidence, if he believed that it would have been favorable; and c.) no reasonable excuse for failure to produce the evidence has been shown. (*Kersey v. Rush Trucking Co.*, 344 Ill. App. 3d 690, 696, 800 N.E.2d 847 (2nd Dist. 2003)).

Here, Nicor witnesses who testified that the alleged storage manipulation in 2001 was due to operational and weather issues were paid consultants who admitted that they did not have first-hand knowledge of the events in question. Not only did Nicor fail to produce a company employee engaged in the operation of the GCPP at the time, Nicor actually withdrew testimony from two key consultants, hours before scheduled cross-examination. A reasonably prudent party, which has the burden to defend itself against allegations of hundreds of millions of dollars of harm, would have produced the testimony of former employees, if that testimony would have aided it in its defense. Even if those employees no longer worked for the Company, those employees could have been produced through reasonable diligence. The Commission may, therefore, draw the inference that such testimony would likely be adverse to Nicor.

In summary, Nicor's post-hoc explanations of the reduced storage cycle fail to address two pivotal – and unrebutted – facts: 1) Nicor reduced storage withdrawals to follow the storage credit rate, which increased the Benchmark, as noted above; and 2) Nicor's total storage inventory going into the 2000-2001 winter was significantly less than in previous years, because of reduced contract storage levels – ***not*** because of weather in November and December 2000. CUB Ex. 2.0 Rev. at 29:660-662.

5. The CUB and AG 2001 Storage Adjustment is Limited to 2001, Because That is When the Activity in Question Occurred

In rejecting the 2001 storage adjustments recommended by both CUB and the AG, the Proposed Order states that "[i]t would be necessary to look at the program as a whole and not just a limited period." PO at 17. This statement demonstrates the Proposed Order's fundamental misunderstanding of the issue. It also insinuates that the adjustment recommended by CUB witness Mierzwa and AG Witness Effron was selective in some way. Yet, Messrs. Mierawa and Effron reviewed thousands of documents turned over by Nicor in discovery relating to all periods before, during and after the GCPP was in effect in order to evaluate Nicor's activities under the entire term of the GCPP. See CUB Ex. 1.0 2nd Rev. at 19:477-481; AG Ex. 1.2 at 4:1-17. The 2001 storage adjustment was limited to 2001 because that's the timeframe during which Nicor inappropriately suppressed storage withdrawals. Storage withdrawals in 2000 and 2002 were near normal. See CUB Ex. 1.0 2nd Rev. at 48:1305-1306. Storage withdrawals in 2001 were suppressed because Nicor failed to fill its NGPL contract storage appropriately prior to the winter of 2000-2001 in order to access LIFO gas, and shifted (increased) storage withdrawals to November 2000 to avoid adverse consequences to it under the GCPP. As a result, there was less gas available to be withdrawn from storage in January 2001, reducing January 2001 withdrawals below normal levels and causing Nicor to suppress storage withdrawals for the remainder of

2001 in order to influence the storage credit rate component of benchmark and artificially raise the benchmark and creating false "savings."

Thus, Messrs. Effron and Mierzwa did not "cherry pick" the year 2001 to maximize their adjustment, but rather developed the 2001 storage adjustment because that's what the evidence showed required an adjustment. In addition, CUB has modified its initial 2001 storage withdrawal adjustment from $155 million in Mr. Mierzwa's direct testimony to $128 in response to a claim by Company witness Carpenter that storage activity in 2000 would have been different and this difference needed to be considered under Mr. Mierzwa's adjustment. The Company never contended that additional adjustments for 2002 were also required and CUB submits that there are none. Therefore, CUB has looked at the entire term of the GCPP. Finally, if examination of storage activity during the entire term of the GCPP would have shown a different impact than that recommended by Mr. Mierzwa, it was the Company's burden to present such evidence. The Company had two opportunities to present such evidence and did not because, one can infer, such evidence does not exist.

6. There is Ample Commission Authority to Order the $127 million refund

The Proposed Order incorrectly concludes that "[t]here is no provision under Section 9-244(c) to order this type of refund." PO at 17. This statement ignores the Commission's Second Interim Order which stated that "it will consider for final resolution in this proceeding all issues relating to the operation of the Program Nicor Gas implemented under tariffs filed in accordance with the Commission's Order entered November 23, 1999, in Docket 99-0217, **and all issues relating to any refunds that may be owing to Nicor customers as a result of the operation of the Program…"** If the Commission has the authority to approve the $64 million refund in the Nicor-Staff Stipulation, then it has equal authority to issue the refunds called for by Messrs.

Mierzwa and Effron. The 2001 storage adjustment – just like the adjustments adopted in the Stipulation – addresses Nicor's actions under the GCPP. The relevant statutory criteria in this proceeding are whether the program met its objectives, including whether the program was likely to result in rates lower than otherwise would have been in effect under traditional rate of return regulation. 220 ILCS 5/9-244(c). As explained above and in CUB's Initial and Reply Briefs, Nicor's actions under the GCPP utterly failed to meet this objective, as its actions under the GCPP actually caused substantially higher rates.

B. EXCEPTION # 2: Storage Inventory Carrying Charges

The Proposed Order summarily rejects CUB's proposed adjustment to Nicor's storage inventory carrying charges: once again, with little to no analysis. The Proposed Order concludes, essentially, that the increased costs relating to base rate storage gas are perfectly acceptable, because Nicor refunded the profits it generated from the LIFO sales. PO at 21. The Proposed Order again misses the point: the impact of Nicor's scheme to liquidate low-cost LIFO layers outside regulatory review went beyond ratepayers being denied the full value of this low-cost gas. More damage was done in the form of higher base rate carrying charges on the higher cost gas that replaced those low-cost LIFO layers and this damage must be reversed.

When a utility like Nicor purchases gas and injects it into storage, it is not able to collect the cost of purchasing that gas from ratepayers until it is withdrawn from storage. CUB Ex. 1.0 2nd Rev. at 35:969-974. Thus, the utility has an investment in its storage inventory. *Id.* In the base rate-setting process, a utility's average investment in storage inventory is reflected as an addition to rate base upon which the utility is permitted to earn a return. *Id.* at 35:971-973. This return is commonly referred to as storage inventory carrying charges. *Id.* at 35:974. So, while Nicor enjoyed 50% of the benefit of the low cost LIFO gas, it began to realize a significant

benefit from the collection of additional base rate revenues on the higher cost replacement gas after the conclusion of its base rate case in September 2005 (Docket No. 04-0779). Therefore, the supposed benefit of liquidation of low-cost LIFO storage inventory under the PBR actually *increased* ratepayers costs, because of the offsetting adverse impact on ratepayers of the increase in Nicor's storage inventory carrying charges.

As explained above, under the PBR, ratepayers received 50 percent of the benefit associated with liquidating low-cost LIFO inventory. During the 2000 through 2002 PBR period, Nicor liquidated approximately 27,600,000 Dth of its low-cost LIFO inventory. CUB Ex. 1.0 2nd Rev. at 35:978-979. The 27,600,000 Dth of low-cost storage inventory liquidated by Nicor during the term of the PBR had an average cost of approximately $2.30 per Dth. *Id*. at 35:979-980. The savings generated by the liquidation of low-cost LIFO inventory was $48.0 million. CUB Ex. 1.09. Since that time, Nicor replaced the 27,600,000 Dth liquidated under the PBR with gas having an average cost of $5.81 per Dth. *Id*. at 35:978-983, *citing* CUB Ex. 1.10. Thus, the benefit to ratepayers under the PBR was $24.0 million, or 50 percent of the total savings amount. But, significantly, this was a *one-time* benefit for ratepayers. CUB Ex. 1.0 2nd Rev. at 35:938. This short-term, limited benefit was in fact far outweighed by the increase in storage carrying charges of the more expensive gas subsequently injected into storage. And the effects of this detriment are lasting: ratepayers will likely pay the higher rates associated with the higher base rate case in perpetuity.

Mr. Mierzwa calculated the additional annual carrying charge costs to ratepayers associated with replacing the low-cost storage inventory with higher cost gas as approximately $6.8 million annually. CUB Ex. 2.0 Rev. at 34:949-952. Because it was unreasonable for Nicor

to liquidate its low-cost storage inventory, it should be denied carrying charges on the difference in cost between the $5.81 and $2.30 per Dth priced gas. CUB Ex. 1.0 2nd Rev. at 35:983-986.

In November 2004, the Company filed a base rate increase request seeking to recover the higher carrying charges associated with the higher cost replacement gas. See *Northern Illinois Gas Company d/b/a Nicor Gas Company*, Proposed general increase in natural gas rates, ICC Docket No. 04-0779, Order at 14 (Sept. 20, 2005). CUB proposed a similar adjustment in Nicor's 2004 rate case, ICC Docket No. 04-0779, and the Commission determined that since the issue of whether it was reasonable for Nicor to liquidate low-cost gas in storage while the GCPP was in effect is being addressed in this case, the instant docket was the more appropriate venue to consider this adjustment:

> The issue of whether it was reasonable for Nicor to liquidate certain low-cost Gas in Storage inventory while the GCPP was in effect is being separately litigated in Docket 02-0067. Because that issue will be given full consideration in Docket 02-0067, and because appropriate remedies are available in that case, that issue will not also be addressed in the present case. Further, if Nicor were penalized in the instant case for a result that remains uncertain at this point in Docket 02-0067, Nicor would have to wait until its next rate case to remedy the situation. It is more just to impose appropriate refunds to ratepayers in Docket 02-0067 should that case be decided against Nicor after all the evidence has been heard and considered.

ICC Docket No. 04-0779, Final Order of September 20, 2005 at 19. Pursuant to the Commission's ruling in Docket No. 04-0779, therefore, this issue must be addressed in this proceeding. Nicor, in fact, supported that conclusion – arguing in favor of addressing this adjustment in this case rather than in that docket. *Id*. at 15. The Proposed Order is, therefore, incorrect that "The Commission rejected the argument of CUB that the carrying charges of Nicor should be disallowed." PO at 21. In fact

Mr. Mierzwa's recommendation reduces Nicor's storage inventory rate base claim in Docket No. 04-0779 from $98.7 million to $52.9 million. *Id*. at 36:1005-1007. This has the effect of reducing Nicor's base rate revenues by $6.8 million per year. *Id*. The base rates approved in Docket No. 04-0779 will have been in effect for at least seven years by the conclusion of this proceeding. CUB Ex. 2.0 Rev. at 25: 574-578. Nicor will thus have recovered an additional $47.6 million in carrying charges from ratepayers (7 x $6.8 million). *Id*. Furthermore, these storage inventory carrying charges reflected in Nicor's current base rates have already been collected from ratepayers and will continue to be collected by the Company. Therefore, Mr. Mierzwa recommends that, in addition to the $40.8 million to be refunded, current base rates should be reduced by $6.8 million per year on a prospective basis. *Id*. at 24:545-548.[5]

The Company should not be allowed to retain the profit (and deny ratepayers their fair share of such savings) resulting from a scheme hatched and implemented outside regulatory purview, the accounting of which was found to be improper, while simultaneously collecting higher rates from ratepayers in the form of higher storage carrying charges. The long-term effect of Nicor's decision to access LIFO layers under the GCPP was higher gas costs, which stands in violation of Section 9-244(b)(1) of the PUA. The Commission approved the GCPP without

[5] While the Proposed Order did not provide an analysis of the general rule against retroactive and single-issue ratemaking legal issue in its analysis and conclusion on this issue, it warrants a brief mention. Generally, the rule makes it improper to consider in isolation changes in particular portions of a utility's revenue requirement or changing rates after they are set, (*Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 405 Ill. App. 3d 389, 410 (2nd Dist. 2010) ("*ComEd*"), Illinois courts have carved out exceptions. For example, when a cost is imposed on a utility by an external circumstance over which the utility has no control, use of a rider (and thus, single-issue ratemaking) is permissible. *Id*. In this case, exceptional circumstances exist that similarly warrant an exception to the general rule against single issue and retroactive ratemaking. The Utah Supreme Court, for example, recognizing two exceptions to the general rule prohibiting single-issue or retroactive ratemaking: (1) extraordinary and unforeseeable expenses or revenues, and (2) "utility misconduct." Utah Public Service Commission Docket No. 88-049-18, Order of August 31, 1998 at 1, *citing MCI Telecommunications Corp. v. Public Service Commission*, 840 P.2d 765, 775-76 (Utah 1992). Here, Nicor's evasion of detection of its true intentions under the GCPP meets any threshold of "utility misconduct," and is therefore worthy of an exception to the general rule against single-issue and retroactive ratemaking.

having the benefit of evaluating all the implications of the decision to liquidate this low-cost gas. This is yet another example of how Nicor's profiteering strategies under the GCPP stand in violation PUA's requirement that "the program is likely to result in rates lower than otherwise would have been in effect under traditional rate of return regulation for the services covered by the program…" 220 ILCS 5/9-244(b)(1).

C. EXCEPTION # 3: LIFO

The only issue that remains with regard to the sharing of the LIFO advantage is the proper calculation of this benefit. The Proposed Order adopted the adjustment as calculated in the Stipulation between Nicor and Staff rather than the calculation used by Mr. Mierzwa. Proposed Order at 25. As discussed in CUB's Initial Brief, Nicor Gas had large stores of low-cost LIFO gas on its books. The market value of this gas was significantly in excess of its book value, which was about $0.30 per dekatherm (Dth). CUB Ex. 1.0 2nd Rev. at 20:520-21:535. Ratepayers realize a benefit from the liquidation, or withdrawal, of low-cost LIFO gas by only paying for the costs of the low-cost LIFO gas rather than the higher market cost of the gas initially injected into storage. *Id*. Nicor itself identified a total of $48.5 million in savings that were attributable to the liquidation of low-cost LIFO inventory. CUB Ex. 1.0 2nd Rev. at 31:874-878.

The Proposed Order agreed that "the entire LIFO benefit should accrue to Ratepayers," but rejects CUB's calculation of the LIFO benefit in favor of Staff's. Proposed Order at 25. The Proposed Order criticizes CUB's reliance on CUB Ex. 1.04 as support for Mr. Mierzwa's calculation because it is a "speech and is certainly not adequate support for the type of adjustment requested here." *Id*. In fact, the document Mr. Mierzwa relied on is a Post Board of Directors Presentation ("PBD Presentation")—a reliable source of the Company's own valuation

of the benefit of the LIFO liquidation. The PBD Presentation reveals that the Company itself valued the benefit of the LIFO inventory liquidation in the PBR at $25 million. CUB Ex. 1.04 at 5. While this document is not dispositive, it corroborates Mr. Mierzwa's calculation. This figure is also supported by CUB 1.08, which shows a LIFO decrement value for 2000 and 2001 which adds to $48.5 million. The Commission must consider the Company's own assessment of this benefit as evidence of its true value. A more reliable source of this assessment would be difficult to find than a Presentation to the Board of Directors.

Mr. Mierzwa's recommendation to credit $24.0 million for the LIFO benefit is more closely aligned with the Company's own valuation and ensures that 100 percent of the benefits associated with the liquidation of low-cost LIFO inventory will be credited to ratepayers. CUB's LIFO adjustment is based on the difference between market costs and low-cost LIFO layer costs weighted by the storage injection percentages included in the Storage Credit Adjustment component of the PBR (CUB Exhibit 1.09), and is corroborated by the Company's own calculations. Witness Zuraski's LIFO adjustment – $21,871,934, the amount included in the Nicor-Staff stipulation – is based on an average of monthly market prices which existed during the 2000-2002 PBR period, weighted by the monthly quantities of gas deliveries to customers. Staff Ex. 1.0 at 22:436-445.

In order to properly account for the total value of the LIFO benefit that is due ratepayers, the Commission must revise the LIFO benefit agreed to in the Stipulation to $24 million. Therefore, the Commission should order an additional $2,128,066 refund to that agreed to in the Stipulation, in order to provide ratepayers with the entire value of the LIFO-derived savings.

D. EXCEPTION # 4: Miscellaneous Additional Language

In addition to the exceptions language in the sections of the Proposed Order identified above, the attached CUB Exceptions also includes proposed language in several other sections of the Proposed Order to complete the Procedural History, add a Legal Standards section, add relevant facts to the descriptions of the issues in the Uncontested Issues/Stipulation section, add a description of the GCPP benchmark formula in the Contested Issues section, and add a section entitled "Further Observations on Nicor's Conduct." CUB believes this additional language is necessary to provide the necessary context and facts with which to substantiate any Commission conclusions in this proceeding.

IV. ORAL ARGUMENT REQUESTED

CUB requests CUB requests oral argument pursuant to 83 Ill. Adm. Code § 200.850(a)(3). CUB believes the record would benefit from argument of the following issues:

- The 2001 Storage Adjustment
- The Storage Carry Charges Adjustment

The Commission routinely grants oral argument in proceedings similar to this one. The Commission would benefit from oral argument on the issues identified and would be able to seek input from the parties on these very complicated and serious issues.

V. CONCLUSION

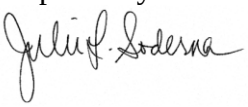
The Proposed Order gives short shrift to the very serious issues that remain in this proceeding, which has spanned nearly 11 years and has cost the Commission and the parties endless time and resources. The record evidence demonstrates – with more than a

preponderance of the evidence – that the proposed 2001 storage withdrawal adjustment of approximately $128 million (before interest) is warranted to correct for the Company's extensive manipulation of the GCPP, over and above what the Company has already agreed to refund. The record further supports an adjustment of $6.8 million per year since the higher gas costs went into base rates in September 2005, ($47.6 million to date), to account for the increased base rate costs relating to the substantial increase in the cost of gas used to replace the low-cost LIFO gas. Finally, the Company's own calculation of the full value of the LIFO benefit (from use of storage pre-fills) supports a Commission finding that is $2.1 million higher than the Nicor-Staff Stipulation.

CUB therefore respectfully requests that the Commission modify the Proposed Order as proposed in the Exceptions attached to this Brief on Exceptions for the reasons stated herein.

Dated: November 28, 2012

Respectfully submitted,



Julie L. Soderna
Director of Litigation
CITIZENS UTILITY BOARD
309 W. Washington, Ste. 800
Chicago, IL 60606
(312) 263-4282
jsoderna@citizensutilityboard.org